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IN THE

Supreme Court of the United States

October Term, 1948
No. 666

BROOKLYN AND RICHMOND FERRY COMPANY, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

A. Chauncey Newlin,
Counsel for Petitioner.

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BROOKLYN AND RICHMOND FERRY COMPANY, INC.,
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v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered December 23, 1948 (R. 139a).

Opinions Below

The opinion of the Tax Court (R. 111a) is reported at 9 T. C. 865. The opinion of the Court of Appeals (R. 133a) is reported at 171 F. (2d) 616.

Jurisdiction

The judgment of the Court of Appeals was entered on December 23, 1948 (R. 139a). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 935.

Question Presented

The question presented is whether certain amounts paid during the years 1939 to 1943 by Electric Ferries, Inc. to the sole stockholder of petitioner are includible in petitioner's income for Federal income tax purposes. The payments were made pursuant to an agreement under which petitioner continued to operate its business for its own account and petitioner's sole stockholder, the payee of the amounts in question, transferred for a period of time to Electric Ferries, Inc. the right to select a majority of petitioner's directors and the right to any dividends on her stock.

Statutes and Regulations Involved

Internal Revenue Code:

Sec. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

Regulations 103[1]

SEC. 19.22(a)-20. *Income to lessor corporation from leased property.* — If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made

[1] Regulations 103 are applicable to 1941. Regulations 111 are applicable to 1942 and 1943. Sec. 29.22(a)-19 of Regulations 111 is identical with Sec. 19.22(a)-20 of Regulations 103 and is not set out here.

by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

Statement

Petitioner for many years has operated a ferry boat line from Brooklyn to Staten Island, N. Y., under franchise granted by the City of New York (R. 75a, 80a, 96a). The franchise in effect during the years in question was granted December 29, 1933 (R. 112a, 25a), is for a term of twenty years beginning March 31, 1934 (R. 26a), is subject to cancellation for failure to operate ferries according to a prescribed schedule (R. 30a, 34a, 112a), and is also cancellable by the City of New York after ten years from its date, irrespective of default (R. 35a).

Under the terms of the franchise the petitioner does not have the right to assign, set over, let or underlet, or in any manner charge or encumber it, or any part of it or interest in it, without first obtaining the consent in writing of the Commissioner of Plant and Structures of the City of New York (R. 112a, 33a). All rights, privileges and benefits under the franchise are available to the petitioner alone, and are subject to the condition against assignment, whether by operation of law or otherwise (R. 36a).

The franchise has not been conveyed or assigned by petitioner or cancelled by the City, and is still held by petitioner and is still in full force and effect (R. 112a, 110a).

Petitioner had practically no assets except the franchise (R. 112a, 97a) and the ferry line could not be operated without it (R. 112a, 85a).

Since 1934 all of petitioner's stock has been owned by May G. Van Lockhorst (formerly Schoonmaker), sometimes herein referred to as the "Stockholder" (R. 112a, 68a).

Electric Ferries, Inc. is a corporation engaged in the ferry boat business in the New York area and operates a ferry boat line across the Hudson River between Manhattan and New Jersey (R. 108a, 109a, 112a, 113a). It is also engaged in the business of renting and leasing ferry boats under bare boat charters to other operators of ferry lines (R. 113a, 106a).

Petitioner does not own, and during the period involved did not own, any ferry boats (R. 75a, 101a, 103a). The ferry boats which it operated before 1939 it chartered from another corporation (R. 75a). Petitioner has a good location for a ferry business but before 1939 it did not keep the boats and terminals in proper condition, and it was not otherwise properly managed (R. 113a, 88a, 100a). It was in very weak financial condition (R. 113a, 67a, 76a).

About February 1, 1939 a Federal inspector made an inspection of the boats and facilities used by petitioner and prohibited further operation of its ferries unless certain extensive repairs were made (R. 113a, 75a). The orders in effect amounted to condemnation of the boats (R. 113a, 75a). Petitioner could not comply with these orders (R. 113a) and was faced with the prospect of losing its franchise because of inability to maintain operations (R. 77a). In order not to lose the franchise it was imperative that peti-

tioner make some arrangement whereby it could use other ferry boats in operating its line (R. 113a, 81a).

Negotiations ensued looking toward a sale by Mrs. Schoonmaker of her stock in petitioner to Electric Ferries, but the parties could not agree on a price (R. 66a, 76a, 80a, 92a, 93a, 100a, 103a, 105a, 113a).

Since the franchise was not assignable its value was dependent on continued operation of petitioner's business as such. Electric Ferries was willing to charter ferry boats to petitioner to enable it to continue in business provided that, during the time its boats were being operated by petitioner, it could put its own people in to manage petitioner's business. (R. 92a, 93a, 97a, 104a.)

Time was of the essence, and in two days the parties put together, in haste, a rather long and complicated agreement which, while ambiguous in some respects, it is claimed constituted in effect a lease by Mrs. Van Lockhorst (then Schoonmaker) of all of her stock in petitioner to Electric Ferries in consideration of certain payments to be made to her by Electric Ferries, the stock to be held during the term of the agreement by an escrow agent (R. 50a, 76a, 77a, 81a, 86a).

The agreement was dated February 8, 1939 and the parties to it were Electric Ferries (referred to as "Lessee"[2]), petitioner (referred to as the "Ferry Company"[3]), petitioner's sole stockholder, Mrs. Schoonmaker (referred to as the "Stockholder"), and Courtland Palmer as escrow agent. (R. 50a.)

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[2] An appropriate term, as a lessee of petitioner's stock.

[3] Note petitioner is not referred to as "Lessor."

The opening WHEREAS clauses state "WHEREAS, (petitioner) is now the owner of a Franchise * * * and * * * it is the desire of all of the parties hereto that (Electric Ferries) shall cause (petitioner) to use and maintain * * * ferries * * * on the said ferry line, * * *." (R. 50a, 51a.)

Article FIRST provides "The (petitioner) and the (Stockholder) do hereby rent, lease and set over unto (Electric Ferries) and (Electric Ferries) does hereby accept, the management and control of (petitioner) from the Stockholder[4] for" the term of the franchise and for any renewal or extension, "and (Electric Ferries) agrees to pay to the said Stockholder as an operating expense of the business, ten (10%) percentum net, of the gross income from the operation of the said ferry line or business from whatever source derived, payable monthly * * *." (R. 51a.)

Article SECOND provides that petitioner "agrees to turn over the management and operation of the * * * ferry line to (Electric Ferries) on March 1, 1939 at 12:01 A. M., to operate under the existing franchise and leases from the City of New York, and any renewals or extensions thereof, * * *."[5] (R. 52a.)

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[4] Literally, this language says that A and B lease the control of B to C, and C accepts it from A. Since control of a corporation is in the stockholders, who elect directors, who in turn appoint management, the agreement is correct in stating that *the Stockholder* rents and leases management and control of petitioner to Electric Ferries, and Electric Ferries accepts such management and control *from the Stockholder*. The agreement is inartistic in coupling petitioner with its stockholder immediately before the phrase "rent, lease and set over unto the Lessee." (R. 51a.)

[5] The Court of Appeals thought (R. 138a) the result was Electric Ferries acted as "managing agent" of petitioner. This view scarcely supports the Court's conclusion that the payments were consideration for something transferred by petitioner.

In Article THIRD Electric Ferries agrees "to cause" petitioner "to fulfill and carry out all of the liabilities and obligations imposed upon" it by the franchise, "to provide the management for the aforesaid ferry line and the necessary modern up-to-date ferry boats and crews to operate the same during the term of this agreement," and "to cause" such "operation to be carried out in accordance with the provisions of the existing franchise and leases." (R. 52a.)

In Article FOURTH the "Stockholder agrees to put (Electric Ferries) in possession of (petitioner) on March 1, 1939, by transferring the ownership[6] of all of the capital stock" of petitioner to Electric Ferries "by placing it in the name and possession" of the Escrow Agent. (R. 52a.)

It is further provided in Article FOURTH that Electric Ferries shall nominate three out of four directors of petitioner, that resignations of petitioner's officers and directors designated by Electric Ferries shall be delivered to the Escrow Agent, and that such resignations can be used by him upon termination of the agreement or in the event of an earlier breach of the agreement by Electric Ferries. Events of default are listed. One event is "failure to pay the rental to the Stockholder." (R. 53a, 54a.)

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[6] The word "ownership" is not particularly apt since, in view of the inability to agree on a price for the stock (R. 113a), it was never contemplated that Mrs. Van Lockhorst would part with ownership of her stock in the ordinary sense. But the words are words *of transfer by the Stockholder* of her rights and interest in the stock to Electric Ferries for the period, and under the terms, of the agreement. Thus, Article FOURTH in terms constitutes a leasing of petitioner's stock by the Stockholder. See *Zachry* v. *Nolan*, (C. A. 5) 66 Fed. 467; *Fletcher, Cyclopedia of the Law of Private Corporations* (1932 Ed.), Section 5681; *Thompson on Corporations*, 3rd Ed., Section 4247.

In Article SEVENTH Electric Ferries agrees to cause petitioner to pay all taxes "on its income" and all operating expenses of its business, and Electric Ferries agrees that upon expiration of the agreement petitioner shall be free of all liabilities and claims. (R. 57a, 58a.)

In Article EIGHTH Electric Ferries agrees not to operate a competing line nor "to run the *said* Ferry line independently of (petitioner), directly or indirectly." (Italics ours.) (R. 58a.)

Article NINTH provides for collection of ferry tolls by petitioner and for depositing them in a bank account in its name. (R. 58a.)

Under Article SIXTEENTH all dividends paid by petitioner after March 1, 1939 "received by the Escrow Agent shall be endorsed over to" Electric Ferries. (R. 60a.)[7]

By amendments to the agreement the provisions as to payments to the Stockholder were changed on November 10, 1939 so as to provide for "annual rental" of $24,000 plus 10% of annual gross income in excess of $400,000, and later, on December 1, 1941, were further changed to make the "annual rental" $34,000 flat. (R. 136a, 42a, 38a.)

Pursuant to the agreement of February 8, 1939, all of the stock of petitioner was transferred by Mrs. Van Lockhorst to Palmer, as escrow agent, and the directors and officers of petitioner resigned (R. 78a, 53a). On February 28, 1939 the escrow agent, by voting the stock of petitioner, elected a new board of directors consisting of four mem-

[7] From time to time petitioner declared dividends and paid them by check to the escrow agent, who endorsed the checks to Electric Ferries, pursuant to the agreement (R. 121a, 136a).

bers, three of whom were selected by Electric Ferries, and the other being himself. The Board then selected nominees of Electric Ferries as officers of petitioner. The officers so elected held like offices with Electric Ferries. These officers thereafter managed and operated petitioner's business. (R. 120a.)

Electric Ferries immediately made ferry boats available to petitioner and thereafter, and during the taxable years, petitioner chartered ferries from Electric Ferries. These ferries were chartered on a bare boat basis and petitioner continued to operate under its franchise, to employ its own crews, to collect all revenues, and to pay its operating and all other expenses, including the cost of repairs to terminals. (R. 120a.) The only change in petitioner's operation was the acquisition of new management and the chartering of boats from a new source (R. 70a, 101a).

The income tax returns filed by petitioner for 1941, 1942, and 1943 reported gross income and net losses as follows (R. 121a):

	Gross Income	*Net Loss*
1941	$545,455.06	$20,954.30
1942	584,229.53	7,873.51
1943	502,301.30	7,911.02

Petitioner deducted as an operating cost for charter hire of boats chartered from Electric Ferries and as management fees, the following amounts (R. 122a):

	Charter Hire	*Management Fees*
1941	$197,625.88	$27,268.01
1942	199,219.30	27,388.96
1943	170,300.94	28,568.48

During the years 1939 to 1943, inclusive, Mrs. Van Lockhorst was paid directly by Electric Ferries, pursuant to the terms of the agreement of February 8, 1939, and amendments thereto, the following amounts (R. 121a):

1939	$18,516.98
1940	24,000.00
1941	37,222.76
1942	34,000.00
1943	34,000.00

Electric Ferries deducted these amounts as operating expenses for Federal income and profits tax purposes, and Mrs. Van Lockhorst included them in her Federal income tax returns for the respective years and paid taxes thereon (R. 121a). The amounts were not reported as income in returns filed by petitioner (R. 121a). The returns of petitioner for the years 1936 to 1939, inclusive, were accepted by the Commissioner of Internal Revenue as filed (R. 121a).

The amounts paid to Mrs. Van Lockhorst by Electric Ferries in the taxable years were included in the income of petitioner by the Commissioner as income taxable to it under Section 22(a) of the Internal Revenue Code (R. 122a).

No property belonging to petitioner has ever been rented to Electric Ferries and at no time has Electric Ferries used the terminal facilities or improvements connected with petitioner's ferry line (R. 79a, 87a, 100a, 101a).

When the agreement of February 8, 1939 was drafted its income tax consequences were not discussed or considered (R. 121a, 78a, 83a, 94a, 99a).

Specification of Error to be Urged

The Court of Appeals erred in holding that the amounts paid by Electric Ferries to Mrs. Van Lockhorst, petitioner's sole stockholder, during the years 1939 to 1943, pursuant to the agreement of February 8, 1939, as amended, were includible in petitioner's income for those years for Federal income and profits tax purposes.

Reasons for Granting the Writ

The decision of the Court of Appeals is in conflict with the decision of the Court of Appeals for the First Circuit in *Denholm & McKay Realty Co.* v. *Commissioner,* 139 F. (2d) 545.

Both in this case and in the *Denholm* case Corporation A made payments directly to the stockholders of Corporation B, and the question was whether the payments were taxable to B. In the *Denholm* case the First Circuit held that the payments were not taxable to B, and in this case the Second Circuit held that the payments were taxable to B.

While the facts of the two cases are dissimilar in detail, the critical feature of both is the same, namely, that Corporation B gave to Corporation A no consideration for the payments to the stockholders of B.

Here, after the agreement of February 8, 1939 petitioner continued to own all of its assets, continued to operate its business for its own account, continued to receive the total income earned from the use of its property, and reported

all such income in its tax returns.[8] It could not receive, constructively or otherwise, rental for the use of its assets by another in addition to the operating income which it derived from the exclusive use of its assets by itself.[9] In fact, petitioner's franchise, virtually its sole asset (R. 97a, 112a),[10] was not assignable without the consent of the City, which was not obtained (R. 112a, 33a).

Instead of leasing property *to* Electric Ferries, petitioner leased, or chartered, boats *from* Electric Ferries, and petitioner operated those boats in its business and it paid rental or charter hire to Electric Ferries for them.[11] Instead of transferring "managerial rights" *to* Electric

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[8] Cf. the statement of the Court of Appeals (R. 138a): "We can see no reason for *eliminating* income from taxation which seems to have been earned through the use of the taxpayer's property." (Italic ours.)

[9] Such cases as *United States* v. *Joliet & C. R. Co.*, 315 U. S. 44, and *Raybestos-Manhattan, Inc.* v. *United States*, 296 U. S. 601, we respectfully submit, are not in point. They involved leases of corporate assets and the lessees operated the properties for their own account. Note the distinction drawn by the First Circuit in *Denholm & McKay Realty Co.* v. *Commissioner, supra.* For the same reason the Commissioner's Regulations, *supra*, p. 3, do not apply.

[10] The Court of Appeals said the petitioner was the owner of the ferry terminals (R. 138a) but they were leased from the City (R. 26a, 27a, 35a).

[11] Whether such charges were reasonable is not involved in this case. Neither upon the audit of petitioner's returns nor upon the trial of the case before the Tax Court did the Commissioner contend that they were not reasonable. If, in fact, they had been unreasonable the Commissioner's remedy would have been to adjust them under Sec. 45, I. R. C.

Ferries, as the Court of Appeals said it did (R. 137a),[12] it purchased management *from* that company (R. 122a).

Under the agreement of February 8, 1939 the consequence of an event of default was not a reversion of property to petitioner, as in the case of a lease, but resignation of the officers and directors of petitioner designated by Electric Ferries and election of new directors by Mrs. Van Lockhorst (R. 53a). She gave to Electric Ferries the right, for a limited time, to select directors of petitioner and to receive the dividends on her stock. And for this she was paid by Electric Ferries.

There is nothing in the record to justify the inference of the Court of Appeals that she "was only brought into the picture in order to obtain from her an irrevocable consent to a leasing of all the corporate assets" (R. 138a). Indeed, she was a vitally necessary party, and, on the other hand, there was little reason for *petitioner* being a party to the agreement because, regardless of some of the language of the contract, actually what Electric Ferries got under it came from the stockholder and not from petitioner. Petitioner kept everything it previously had and, as the Court of Appeals found, simply came to be run by a "managing agent" (R. 138a).

We submit this situation raises the same question that was involved in *Denholm & McKay Realty Co.* v. *Commissioner, supra,* and there the First Circuit reached a conclusion contrary to that of the Second Circuit here.

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[12] While Electric Ferries did in fact acquire the right to select the management of petitioner for a limited period of time, it acquired that right through exercise of the right to select a majority of the directors of petitioner. And since only stockholders elect directors, the right to select directors of petitioner was transferred to Electric Ferries by Mrs. Van Lockhorst, not by petitioner.

In the *Denholm* case the Store Company leased from the Realty Company, the taxpayer, the store property, in consideration for a specified rental and a guarantee by the Store Company of the payment of dividends on the preferred stock of the Realty Company. The original lease was succeeded by later leases but the guarantee of dividends was a continuing obligation of the Store Company. In 1936 the Store Company paid amounts equal to dividends to the holders of the preferred stock of the Realty Company and the Commissioner of Internal Revenue ruled that these amounts should be included in the Realty Company's gross income as rent received. The Board of Tax Appeals upheld the Commissioner, on the authority (as here) of *United States* v. *Joliet & C. R. Co., supra.* The First Circuit reversed on the ground that since the original lease, incident to which the guarantee of dividends had been given, had come to an end in a prior year, the amounts paid to the Realty Company's preferred stockholders in 1936 were not paid in consideration for anything transferred by the Realty Company to the Store Company. The First Circuit (p. 549) distinguished the *Joliet* case for the same reasons which we believe distinguish it from the case here.

In the present case the Court of Appeals apparently attached controlling weight to the *language* of the agreement of February 8, 1939 in concluding that "the agreement was in effect a lease" from petitioner to Electric Ferries (R. 137a). In the *Denholm* case the lease expressly recited that the guarantee of dividends on the preferred stock was "in consideration of the lease" of the real estate. But the First Circuit found this unimportant, saying that such terms did not change "the essential nature of the trans-

action'' (p. 549). So too the language of the agreement here does not change the essential nature of this transaction. Here, as in the *Denholm* case, the payor corporation did not make the payments in consideration for something which it received from the payee stockholder's corporation. Petitioner continued to operate its business for itself, but simply under new management, as indeed the Court of Appeals found (R. 138a).

Since both in this case and in the *Denholm* case the taxpayer corporation did not transfer anything to the payor corporation, in consideration for the payments by the latter to the former's stockholders, it is submitted the two cases involve the same question, and since the First Circuit found that under those circumstances the payments could not be attributed to the taxpayer corporation, but the Second Circuit here reached a contrary conclusion, it is submitted the decisions below are in conflict.

Conclusion

For the foregoing reasons it is respectfully submitted this petition should be granted.

A. Chauncey Newlin,
Counsel for Petitioner.

March 1949

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 666

BROOKLYN AND RICHMOND FERRY COMPANY, INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 111a-130a)[1] are reported at 9 T. C. 865. The opinion of the Court of Appeals (R. 133-137) is reported at 171 F. 2d 616.

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[1] "R" references are to the Appendix to taxpayer's brief below as supplemented by the opinion and mandate of the Court of Appeals.

JURISDICTION

The judgment of the Court of Appeals was entered on December 23, 1948. (R. 137.) The petition for a writ of certiorari was filed on March 23, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

QUESTION PRESENTED

Taxpayer and its sole stockholder contracted with another corporation for a "lease" of the management and control of taxpayer's business, consisting mainly of a ferry franchise and terminals. As consideration the stockholder received from the managing corporation sums not dependent upon taxpayer's income and the managing corporation received from taxpayer management fees, charter hire for boats furnished by it, and dividends. The question is whether the amounts received by the stockholder from the managing corporation are income to the corporation under Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the

ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-20.[2] *Income to lessor corporation from leased property.*—If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not re-

[2] These Regulations are applicable to the year 1941. Section 29.22(a)-19 of Treasury Regulations 111, promulgated under the Internal Revenue Code, identical with Section 19.22 (a)-20 of Regulations 103, is applicable to 1942 and 1943 which are also here involved.

lieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

STATEMENT

The facts found by the Tax Court (R. 112a-123a) may be summarized as follows:

Taxpayer, a New York corporation, had the exclusive right to operate ferry boats from Bay Ridge, Brooklyn, New York, to St. George, Staten Island, New York, for a term of twenty years beginning in 1934. The franchise, nonassignable without consent of the City of New York, was subject to cancellation on default of taxpayer including failure to operate the ferries according to a prescribed schedule. The franchise, taxpayer's most valuable asset, has not been conveyed or assigned and is still in force. Without it taxpayer could not have operated a ferry line. (R. 112a.)

During 1939 and all times since, May G. Van Lockhorst, then May G. Schoonmaker, hereinafter referred to as the stockholder, owned all of the outstanding capital stock of taxpayer. (R. 112a-113a.)

Taxpayer had a good location for a ferry business but was mismanaged. About February 1, 1939, a federal inspector issued orders equivalent to condemnation of the boats obtained by taxpayer under bare boat charter. Taxpayer could not comply with the orders of the inspector because of lack of funds and time. Since it was essential that taxpayer make immediate arrangements for ferries to use in the operation of its lines to avoid default, stockholder's attorney, after failing in his effort to have the inspector's orders modified, consulted Electric Ferries, Inc., a New Jersey corporation hereinafter referred to as the management corporation, first with respect to the sale of stockholder's stock to it and then to obtain boats to operate the line. Negotiations resulted in the execution of an agreement in 1939 among the stockholder, taxpayer, the management corporation and stockholder's attorney as escrow agent. (R. 113a-114a.)

In relevant part the agreement provided that taxpayer and its sole stockholder (R. 114a)—

> hereby rent, lease and set over unto the Lessee [the management corporation] and the Lessee does hereby accept, the management and control of the Ferry Company from the Stockholder for the full balance of the term of the said Franchise * * * and for any renewal or extension thereof, as hereinafter provided, and the Lessee agrees to pay to the said Stockholder as an operating expense of the business,

> ten (10%) percentum net, of the gross income from the operation of the said ferry line or business from whatever source derived, payable monthly * * * .

The taxpayer also agreed to "turn over the management and operation of the * * * ferry line to the Lessee * * * to operate under the existing franchise and leases from the City of New York, and any renewals or extensions thereof * * * ." The management corporation agreed to cause the taxpayer to carry out all the liabilities and obligations imposed upon it and to provide management of the ferry line and the necessary ferry boats and crews. The stockholder agreed to put the management corporation in possession of the taxpayer by transferring the ownership of all of her capital stock to the management corporation and placing it in the name of her attorney, Courtland Palmer, as escrow agent. She also agreed to obtain the resignations of each of the existing directors and officers of taxpayer and to elect a board of four new directors, three of whom should be the nominees of the management corporation and one of whom should be the nominee of the stockholder. The management corporation agreed to deposit with the escrow agent the resignation of each of its officers and directors to be used by that agent only in the event of failure to pay the rental to the stockholder or certain other defaults. (R. 114a-117a.)

It was further agreed that the management corporation should be entitled, through its management of the Ferry Company, to possession of the franchise and rights of the Ferry Company and thereby to possession of all of the physical assets of that company for the use and operation thereof. The management corporation agreed to cause the Ferry Company to pay all taxes on its income and all expenses including sums to accrue to the City of New York for the franchise to operate the ferry line. It also agreed to cause the Ferry Company monthly to pay all obligations against it and not to permit any obligations to remain that were over forty days old. The management corporation also agreed to cause the Ferry Company to collect ferry tolls, but the latter was not to pay therefrom any salaries, dividends, or the charter hire due to the management corporation or to pay any other expenses not incurred in the operation of the ferry business until after the monthly payment due to the stockholder. Any dividend checks received by the escrow agent were to be endorsed over to the management corporation "as the owner of the stock held in the name of the Escrow Agent." (R. 117a-119a.)

By amendments of the agreement, the payments by the management corporation to the stockholder were changed on November 10, 1939, so as to provide for an "annual rental" of $24,000 plus 10 percent of all gross income in excess of $400,000 and

later, on December 1, 1941, were further changed so that the "annual rental" was increased to $34,000. (R. 120a.)

During the taxable years, the Ferry Company chartered ferries from the management corporation on a bare boat basis, continued to operate under its franchise, to employ its own crews, and pay its operating expenses, including the cost of repairs to terminals. At undisclosed times, the Ferry Company declared dividends and paid them by check to the escrow agent, who endorsed over the checks to the management corporation. During the years 1939 to 1943 inclusive, the stockholder was paid directly by the management corporation pursuant to the terms of the original agreement and the amendments thereto in the amounts of $18,516.98, $24,000, $37,222.76, $34,000, and $34,000 respectively. The management corporation deducted these amounts as operating expenses for federal tax purposes, the stockholder included them in her income tax returns for the respective years and paid taxes thereon, but those amounts were not reported as income on returns filed by the taxpayer. The income tax returns of the taxpayer showed a net loss in each of the taxable years. It deducted as an operating cost the charter hire of boats paid by it to the management corporation and certain annual sums of about $27,000 as management fees on the part of the management corporation. (R. 120a-122a.)

The Commissioner included in taxpayer's income the amounts paid from 1941 to 1943 to the stockholder by the management corporation. The Tax Court approved the Commissioner's action and the Court of Appeals affirmed, both holding on the authority of this Court's decision in *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, that the amounts paid by the management corporation to taxpayer's stockholder were income to taxpayer because the income was derived from the use by the management corporation of taxpayer's property. (R. 123a-130a, 136-137.)

ARGUMENT

Both of the courts below viewed the agreement among taxpayer, its stockholder, the escrow agent and the management corporation as "in effect a lease of the franchise and managerial rights" of taxpayer to the management corporation (R. 127a, 136) in consideration for which the management corporation made payments to taxpayer's stockholder. So viewed, there can be no question that the payments constituted income to the taxpayer under the basic rule that income is taxable to the one who earns it; and this result may not be avoided by anticipatory arrangement regardless of the form it assumes. *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *National Carbide Corp.* v. *Commissioner*, decided by this Court March 28, 1949 (slip op. p. 13); *Commissioner* v. *Sunnen*, 333 U. S. 591; *Harrison* v. *Schaffner*, 312 U. S. 579;

Helvering v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Burnet* v. *Leininger*, 285 U. S. 136; *Lucas* v. *Earl*, 281 U. S. 111; Cf. *Raybestos-Manhattan, Inc.* v. *United States*, 296 U. S. 60; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; *Helvering* v. *Clifford*, 309 U. S. 331; *Douglas* v. *Willcuts*, 296 U. S. 1.

We think that a consideration of the involved and somewhat contradictory agreement (R. 38a-63a) leaves little doubt of the correctness of the conclusions below. Both the form and substance of the unique but readily understandable device was that of a lease of taxpayer's management to permit the lessee to exploit taxpayer's nonassignable franchise.[3] The fundamental difference[4] between the taxpayer and the Commissioner is only whether in fact the valuable management rights of taxpayer were leased so that the payments to the stockholder were derived from the taxpayer, as the

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[3] Taxpayer's argumentative statement of the case (Pet. 4-11) is based in no small part on a highly selective reference to the agreement and on footnote inferences which it draws that were urged upon both courts below and there rejected.

[4] That the disagreement turns on nothing more fundamental than the proper interpretation of a unique agreement was succinctly stated in the opening paragraph of taxpayer's reply brief in the Court of Appeals as follows:

> The difference between the parties may be simply stated. The taxpayer contends the consideration for the payments made by Electric Ferries to Mrs. Van Lockhorst came from her. The Commissioner contends the consideration came from the taxpayer. • • •

Commissioner contends, or whether, contrary to the terms of the agreement and the findings of both courts below, the agreement was a "lease" of the stockholder's stock in taxpayer.[5]

Taxpayer's sole reliance for issuance of the writ, that the decision is in conflict with the decision in *Denholm & McKay Realty Co.* v. *Commissioner*, 139 F. 2d 545 (C. A. 1st), therefore, is without merit. The facts in *Denholm* characterized by the First Circuit (p. 546) as "somewhat peculiar" were that the payments made by the store company (the status of which was somewhat analogous to the management corporation here) to some of the preferred stockholders of the taxpayer were not in consideration of the lease of the taxpayer's property for which the court found that the store company otherwise made full payment, but were occasioned by a guarantee of the dividends on the preferred stock of taxpayer at a time, years before, when the store company owned the shares.[6] Thus,

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[5] Both courts flatly rejected the "lease" of stock theory. The Court of Appeals (R. 136) stated "the agreement was • • • not in substance or effect a mere lease of the right to vote the stock • • •," and the Tax Court observed (R. 127a) that "The petitioner's idea that the payments related only to a grant of right to vote stock is altogether too narrow, in view of all the facts here involved."

[6] The court stated (p. 547):

> Since all preferred stock of petitioner was issued to the store company in payment for the real estate it seems that the only possible business purpose for the guaranty which the store company executed on the back of such preferred stock certificates was to facilitate the subsequent transfer of this stock by the store company.

to use taxpayer's designation (Pet. 12), the critical feature in *Denholm* that "Corporation B gave to Corporation A no consideration for the payments to the stockholders of B" is not present here because the Tax Court and the Court of Appeals correctly concluded that Corporation B *did* give to Corporation A consideration for the payments to B's stockholder.

The case, then, presents no occasion for issuance of the writ since it is unquestioned that the courts below correctly enunciated the applicable principles of law; the factual findings concurred in by both courts are warranted by the record (cf. *Goodyear Co.* v. *Ray-O-Vac Co.*, 321 U. S. 275, 278; *Virginian Ry.* v. *Federation*, 300 U. S. 515, 542; *Baumgartner* v. *United States*, 322 U. S. 665); there is no conflict of decisions; and the issues presented do not have importance beyond this case.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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